

AR57

PRIMEX

Windspear Business Resources
University of Alberta
1-16 Business Building
Edmonton, Alberta T6G 2H5

1997 ANNUAL REPORT





CORPORATE PROFILE

P RIMEX FOREST PRODUCTS LTD. is a Canadian company dedicated to the production and marketing of high quality lumber products from British Columbia's coastal forests. The Company which began in 1963 now has the following major operations and investments:

- ACORN FOREST PRODUCTS DIVISION, Delta, B.C. specializes in Hemlock structural and finishing components for traditional Japanese houses.
- SPECIALTY PRODUCTS DIVISION, Delta, B.C. is a kiln drying and lumber remanufacturing plant which produces value-added products for the U.S., Japanese and European markets.
- FIELD SAWMILLS LIMITED PARTNERSHIP, Courtenay, B.C. is owned 70% by Primex, which as General Partner manages the business, and 30% by MacMillan Bloedel Limited. Its focus is on high value lumber products for the Japanese market.
- B.W. CREATIVE WOOD INDUSTRIES LTD., Maple Ridge, B.C. is owned 49% by Primex and 51% by B.W. Creative's management. The Company is one of Canada's leading producers of wooden spindles, stair parts and other specialty products.

Raw material for the sawmills is purchased competitively in the open market and Primex draws on many years of experience in the procurement of a suitable log supply. Primex continues at the forefront in sawmill technology with the objective of recovering the highest possible value from B.C.'s unique timber resource. Great pride is taken in the strong international customer base, which has been developed since 1973, for the Company's lumber products.

Primex Forest Products Ltd. is a publicly owned company with its shares listed on the Toronto Stock Exchange and the Vancouver Stock Exchange.



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(IN THOUSANDS
OF DOLLARS, EXCEPT
PER SHARE AMOUNTS)

Winspear Business Reference Room
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Edmonton, Alberta T6G 2R6

	1997	1996	1995	1994	1993
Sales	155,784	170,672	160,461	191,625	161,431
Operating income	6,511	9,228	7,907	28,779	23,674
Depreciation	4,104	3,902	3,899	4,092	3,404
Interest	(34)	365	28	524	823
Earnings before income taxes	2,441	4,961	3,980	24,163	19,447
Income taxes	902	1,490	515	9,665	7,875
Net earnings	1,539	3,471	3,465	14,498	11,572

PER SHARE

Pre tax earnings	.28	.55	.46	2.78	2.24
After tax earnings	.18	.40	.40	1.67	1.33
Cash flow from operations	.75	1.02	.91	3.25	2.08
Shareholders' equity	6.95	6.94	6.70	6.55	5.08
Dividends	.16	.16	.25	.20	.21
Share price range:					
- high	9.05	9.75	10.75	11.38	14.50
- low	6.00	6.25	5.88	8.00	8.13
Average number of shares outstanding	8,690,664	8,690,664	8,690,664	8,690,664	8,687,596

YEAR END POSITION

Working capital	41,680	36,388	34,651	39,898	26,882
Capital expenditures	2,117	3,814	3,099	2,160	9,766
Long term debt	6,071	1,032	1,301	7,958	10,656
Shareholders' equity	60,437	60,289	58,209	56,916	44,157
Number of shares outstanding	8,690,664	8,690,664	8,690,664	8,690,664	8,690,664



Primex Forest Products Ltd., Delta, B.C. had net earnings of \$1,539,000 or \$.18 per share for the year ended December 31, 1997 compared to \$3,471,000 or \$.40 per share in 1996. Sales for 1997 were \$155,784,000 compared to \$170,672,000 in 1996.

Fourth quarter net earnings in 1997 were \$264,000 or \$.03 per share on sales of \$32,967,000 compared to earnings of \$3,279,000 or \$.38 per share on sales of \$47,573,000 in the same period of 1996. This year's fourth quarter results were an improvement over the third quarter loss of \$440,000 or \$.05 per share, due primarily to less sawmill downtime.

The most significant reason for the decline in earnings was the increased sawmill downtime in 1997 caused by a dramatic decline in demand for lumber in the Japanese market beginning in the second quarter.

Working capital was \$41,680,000 at December 31, 1997 compared to \$36,388,000 at December 31, 1996. Shareholders' equity increased to \$60,437,000 at December 31, 1997 from \$60,289,000 at December 31, 1996. The net long-term debt to shareholders' equity ratio was .10 to 1.00 at December 31, 1997 compared to .017 to 1.00 at December 31, 1996.

Capital expenditures in 1997 included upgrading the headrig scanners at both sawmills, replacement of mobile equipment at each operation and minor additions to manufacturing equipment at a total cost of \$2,117,000.

Effective April 1, 1997, Primex purchased a 49% equity interest in B.W. Creative Wood Industries Ltd. with the 51% interest being held by B.W. Creative's management. The company, located in



Maple Ridge, B.C. is one of Canada's leading producers of wooden spindles, stair parts and other specialty wood products. This investment contributed to earnings in 1997 and is reflected in the accompanying financial statements by the proportionate consolidation method.

The Board of Directors has declared a regular quarterly dividend of \$.04 per share on the common shares of the Company payable February 13, 1998 to shareholders of record February 3, 1998. A total of \$1,391,000 or \$.16 per share was paid in dividends during 1997.

Housing starts continued to fall in Japan through the end of 1997 and are expected to be lower in 1998 than 1997. Reduced lumber consumption led to oversupply in the market which will continue through early 1998. Until consumption and supply

return to some balance there will be continued pressure on prices. The price of wood chips, an important by-product, is expected to decline. The cost of open market logs has fallen and supply is good for early 1998 but logging curtailments could put pressure on supply and price during the second quarter.

Respectfully submitted on behalf of the Board.

GEORGE L. MALPASS

President & Chief Executive Officer

March 1998

**INCORPORATION**

The Company was incorporated on May 27, 1963 under the laws of the Province of British Columbia by Memorandum and Articles under the name Evergreen Studs Limited. The Company changed its name to Acorn Forest Products Ltd. in November 1963, to Gregory Manufacturing Limited in April 1972 and finally to Primex Forest Products Ltd. in May 1986.

The Company acts as the general manager in the Field Sawmills Limited Partnership owned 70% by Primex Forest Products Ltd. and 30% by MacMillan Bloedel Limited.

The Company has two wholly owned subsidiaries, Primex Fibre Ltd. and Primex Log Trading Ltd. Primex Fibre Ltd. owns a pulp chip manufacturing facility. This facility chips residual wood from the Acorn Forest Products Division and provides fee for service whole log custom chipping. Primex Log Trading Ltd. procures log supply for the sawmills.

The Company's principal office is located at 9924 River Road, Delta, B.C. V4G 1B5 and its registered office is located at #1300 - 777 Dunsmuir Street, Vancouver, B.C. V7X 1K2.

In this document, a reference to the "Company" or "Primex" means Primex Forest Products Ltd. and its predecessors and all of its subsidiaries.

NARRATIVE DESCRIPTION OF THE BUSINESS

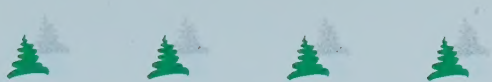
Primex's principal business is the manufacture and marketing of high value lumber products for the Japanese market. The Company's operations and investments include:

- Acorn Forest Products Division (Acorn)
- Field Sawmills Limited Partnership (Field)
- Specialty Products Division (Specialty)
- Timber Division (Timber)
- B.W. Creative Wood Industries Ltd. (B.W. Creative)

Acorn

The Acorn operation, located on the Fraser River in Delta, British Columbia, consists of a log dewatering and merchandising system, a sawmill and a planer mill. The log dewatering and merchandising system was engineered and constructed in 1988. The sawmill was completely rebuilt in 1989 due to a fire that destroyed substantially all sawmilling equipment.

Acorn specializes in the sizes and grades of lumber components used in the Japanese traditional



housing market. Species cut include hemlock, Douglas fir and spruce. Logs are sourced through log/wood chip trades and open market purchases. Sawmill production in 1997 was 129 million feet. Acorn had 201 employees at the end of 1997.

Field

The Field operation, located in Courtenay, British Columbia, consists of a sawmill, in-line planer and planer mill. The sawmill has undergone significant capital improvement over the last few years, adding new breakdown, edging and planer capacity.

Field specializes in the sizes and grades of lumber components used in the Japanese traditional housing market. Species cut include hemlock, Douglas fir, spruce and cypress. Logs are sourced through log/wood chip trades and open market purchases. Sawmill production in 1997 was 74 million feet. Field had 195 employees at the end of 1997.

Specialty

The Specialty operation, located in Delta, British Columbia, consists of dry kilns and lumber remanufacturing equipment. The facility produces

value-added products for the U.S., Japanese and European markets. Specialty had 29 employees at the end of 1997.

Timber

The Timber Division manages timber sales under the British Columbia government's Small Business Forest Enterprise Program. During 1997 67,000 cubic meters of logs were harvested from these timber sales.

B.W. Creative

Primex has a 49% equity interest in B.W. Creative, located in Maple Ridge, British Columbia, which manufactures and markets wooden spindles, stair parts and other specialty products. Its major markets are the U.S., United Kingdom and Canada.

Although Primex has over 200 customers throughout Japan, most sales are made through the large Japanese trading companies which provide services such as trade financing to the end customers. The four largest of these trading companies accounted for in aggregate 57% of the Company's total sales during the year.



1. COMPARISON OF 1997 & 1996 OPERATING RESULTS

	1997	1996
Sales	\$155,784,000	\$170,672,000
Net Earnings \$	1,539,000	\$ 3,471,000
Net Earnings Per Share	\$.18	\$.40

The earnings at the Acorn Forest Products Division (Acorn) and the Field Sawmills Limited Partnership (Field) vary according to lumber selling prices, currency exchange rates, ocean freight costs, log costs, by-product revenues, production volumes and operating costs.

Primex owns 70% of the Field Sawmills Limited Partnership and has included in its accounts 70% of Field's sales and earnings in 1997 by the proportionate consolidation method.

Total sales in 1997 were 71% Japan, 10% Canada, 12% United States and 7% Europe and other offshore. In 1996 total sales were 72% Japan, 14% Canada, 10% United States and 4% Europe and other offshore. Canadian sales include outside log sales from our timber licences and fee for service charges at the Specialty Products Division (Specialty). Sales to Japan and the United States are denominated in U.S. dollars and, therefore, the U.S./Canadian exchange rate has an impact on earnings. On average for the year \$1.00 U.S. bought \$1.3749 Cdn. in 1997 versus \$1.3626 Cdn. in 1996, a favourable change of 1%.

Ocean freight costs, on a per unit basis, were down by approximately 5% in Canadian dollars during 1997 as compared to 1996.

Average net mill lumber selling prices in Canadian dollars increased in 1997 by 3.4% from 1996.

During 1997, Primex sourced 97% of its log requirements on the open market or through chip/log trade agreements, all at market prices. The balance was provided by timber sale licences. Open market log costs fluctuated during the year, but on average they were higher than 1996 by 8.9%.

Primex accounts for its by-product revenue, mainly from wood chips, as a reduction of gross log cost in calculating the cost of lumber produced. Therefore, while changes in by-product revenue do not affect reported sales, they can have a significant impact on margins and, hence, earnings. Revenue from wood chips, on a per unit basis, was 6.9% less than that in 1996.

Acorn lost 40 production days in 1997 due to lack of demand for lumber in the Japanese market compared to 10 days in 1996 due to curtailment on wood chip sales. Total production volume decreased to 129 million board feet from 130 million in 1996. However, production per day increased and per unit manufacturing costs decreased by 3.1%.

Field lost 36 production days due to lack of demand for lumber in the Japanese market in 1997 compared to 12 days lost in 1996. Field's operations were reduced from three shifts per day to two shifts per day in September 1996. As a result of fewer operating days and a two shift per day schedule, total production decreased to 74 million board feet in 1997 from 88 million in 1996. Per unit manufacturing costs in 1997 were 5.0% lower than 1996.

Specialty operates on a "free for service" basis providing kiln drying and lumber remanufacturing services for our own mills and several outside customers. Its earnings, therefore, are related to volume of through-put and operating costs. This division suffered a small loss in 1997, compared to a small profit in 1996.

Primex purchased 49% of B.W. Creative Wood Industries Ltd. (B.W. Creative) effective April 1, 1997. This investment contributed to earnings in 1997 and is reflected in the accompanying financial statements by the proportionate consolidation method.

2. CAPITAL EXPENDITURES

Year	Description	Total
1996	Sawmill improvements including completion of the project to increase chipping capacity at Field Sawmills and replacement of mobile equipment	\$3,814,000
1997	Sawmill improvements including upgrading the headrig scanners at both sawmills and replacement of mobile equipment	\$2,117,000
1998	Sawmill improvements and replacement of mobile equipment approved to February 28, 1998	\$1,087,000

3. FINANCIAL POSITION

During 1997 the Company generated \$4,580,000 from operations. Net reductions in non-cash working capital balances from the levels of the previous year, provided additional cash flow of \$10,402,000. The Company used \$2,693,000 to acquire an interest in B.W. Creative. The Company also used \$2,117,000 to purchase fixed assets, \$1,037,000 to reduce long term debt and \$1,391,000 was paid as dividends. Along with the proceeds on disposition of fixed assets of \$169,000 and

proceeds of long term debt financing of \$5,512,000, this resulted in an increase in cash of \$13,425,000 for the year and cash on hand of \$7,813,000 at December 31, 1997.

During the year the Company's long term debt increased from \$1,032,000 at December 31, 1996 to \$6,071,000 at December 31, 1997. The full amount of this debt is the Company's proportionate share of the long term debt of the Company's joint ventures (Field and B.W. Creative). These joint venture loans consist of a floating rate term bank loan at prime plus 3/8% maturing in 2002, a match funded term loan with interest at 7.44% maturing in 2005, capital lease obligations on certain equipment with interest averaging 5.8% maturing in 2000 and a demand term bank loan with interest at prime plus 3/4% renewable yearly. All of this joint venture indebtedness is non-recourse to the Company.

Shareholders' equity increased to \$60,437,000 at December 31, 1997 from \$60,289,000 at December 31, 1996.

4. LIQUIDITY

At December 31, 1997, the Company had net cash on hand of \$7,813,000 and in addition had unused lines of credit totalling \$21,450,000. The Company's working capital was \$41,680,000 at December 31, 1997 compared to \$36,388,000 at December 31, 1996. The current ratio was 4.63 to 1.00 at December 31, 1997, compared to 2.85 to 1.00 at December 31, 1996. The net long term debt to equity ratio was .10 to 1.00 at December 31, 1997 compared to .017 to 1.00 at December 31, 1996. The capital expenditures completed during 1997 were financed entirely from

cash flow with the exception of the purchase of two log loaders at a cost of \$612,000. The capital expenditures approved to February 28, 1998 will be financed from cash flow.

5. RISKS, UNCERTAINTIES, SENSITIVITIES

(a) Japanese Market Concentration

In 1997 71% of the Company's sales were to Japan. Demand for lumber in the Japanese market fell sharply during 1997 as housing starts dropped by 15.6% from 1996. Housing starts are expected to fall further in 1998 with the average over the next five years being less than the previous five years. Despite this structural change, management believes the Japanese market will continue to be the best market in the world for the Company's products.

(b) Log Supply

The Company's sources of log supply in 1997 were: timber sale licences 3%; wood chip/log trade agreements 36%; and, open market purchases 61%. Logs acquired under chip/log agreements are priced at market.

Prices and availability of logs in the open market are affected by supply and demand factors. The major factors impacting log availability in coastal B.C. are the declining harvest from Crown lands and overcapacity in the manufacturing sectors. Until the overcapacity situation is rectified, sourcing logs suitable for the Company's mills will continue to be a challenge.

(c) Currency Exchange Rates

Primex sells to the Japanese and United States markets in U.S. dollars. In 1997, sales to these markets amounted to 83% of total sales. It is expected that sales to these markets will amount to at least that percentage in 1998. Based on projected sales volumes for 1998, a \$.01 change in the Canadian dollar versus the U.S. dollar at current rates would affect net earnings for that year by

approximately \$1,000,000 or \$.12/share. In order to minimize foreign currency exchange rate volatility, the Company at opportune intervals, will enter into forward exchange contracts hedging future U.S. dollar denominated sales and receivables. During 1997 the Company hedged \$20,949,000 U.S. at an average exchange rate of 1.3635. At December 31, 1997 the Company had outstanding forward exchange contracts totalling \$10,898,000 U.S. at an average exchange rate of 1.3983.

(d) Environmental Constraints/Requirements

The Company has outside consultants monitor its operations on an on-going basis to ensure that the principles outlined in the Company's environment policy are being followed. As well as assessing compliance with existing environmental regulations, the consultants recommend improvements in standards. Projects to improve standards are undertaken as recommended. Based on the consultants' reports, the Board of Directors believes that the Company is in substantial compliance with existing environmental laws.

(e) Softwood Lumber Agreement

On February 16, 1996 an agreement was reached between Canada and the United States of America designed to prevent the U.S. government and forest industry from initiating a countervailing duty investigation of Canadian softwood lumber exports to the U.S. for the next five years.

As a result of the agreement individual Canadian companies were assigned a quota for free access to the U.S. softwood lumber market, with shipment beyond that subject to fees of \$50 U.S. per thousand board feet on a small specified volume and \$100 U.S. per thousand board feet on shipments in excess of that.

The U.S. accounted for 21% by volume (12% by value) of Primex's total sales in 1997. The second year of the quota system expires March 31, 1998 and it appears that Primex will be subject to

payment of fees for shipments in excess of the quota. Three quarters of the estimate of fees payable have been provided for in the 1997 financial statements based on a pro-rata assignment of the fee for the year.

The agreement restricts Primex's ability to increase sales to the U.S. without paying a penalty, which limits Primex's ability to react to changing market conditions.

(f) Year 2000

The "Year 2000 issue" is a general term used to refer to certain business implications of the arrival of the new millenium. In simple terms, these implications arise largely because it has been normal practice in the past for computer hardware and software to use only two digits rather than four to record the year in date fields. On January 1, 2000, when the year is designated as "00" many computer systems could either fail completely or create erroneous data as a result of misinterpretation of the year. The Company believes that it is not significantly affected by this issue.

Based on the Company's inquiries to date the only major software program that is not Year 2000 compliant is the Company's payroll program and replacements for this program are currently being investigated. The Company hopes to have a replacement program in place and fully operational by January 1, 1999 at an estimated total capital cost of approximately \$50,000.

The Company is also currently contacting all suppliers of hardware and software to verify that

their products are Year 2000 compliant. The replies received to date indicate that no major changes are required.

The Company has an Information Systems Management Committee which is refining a strategy to assure that the Company's plan for dealing with this issue is being carried out and also overseeing any remedial action should that be required.

The Company incurred no material cost or expenses during 1997 relating to the Year 2000 issue and expects this issue to have no significant impact on future earnings.

6. OUTLOOK

Housing starts continued to fall in Japan through the end of 1997 and are expected to be lower in 1998 than 1997. Reduced lumber consumption led to oversupply in the market which will continue through early 1998. Until consumption and supply return to some balance there will be continued pressure on prices. The price of wood chips, an important by-product, is expected to decline. The cost of open market logs has fallen and supply is good for early 1998 but logging curtailments could put pressure on supply and price during the second quarter.



Primex Forest Products Ltd. will conduct all of its operations in a manner that promotes environmental sustainability and minimizes the potential for negative impacts on the environment. This principle of continued environmental protection and improvement will be achieved within the framework of regulatory compliance and operation as an efficient and profitable provider of quality forest products.

STATEMENT OF SENIOR MANAGEMENT SUPPORT

Primex's senior management supports and encourages the creation of a corporate Environmental Management System (EMS) to ensure and demonstrate compliance with our stated Guiding Principles and Policy Goals.

Senior management appreciates that development and implementation of an EMS will place additional demands on personnel and resources. They are, however, prepared to make the resources available as they recognize that these will be offset through increased environmental protection, and regulatory compliance, along with reduced liability, waste generation and subsequent treatment costs.

Management also recognizes that only through continued efforts to sustain and improve environmental quality can Primex's continued survival and growth be assured, and that only through continued profitable operation can Primex allocate the resources necessary to achieve their environmental goals and objectives.

ORGANIZATION AND RESPONSIBILITIES

A management and organizational structure has been set up to define and document the responsibility, authority and interactions of key personnel who manage, perform and verify work affecting the environment.

A management structure includes representatives with organizational freedom and authority to:

- ◆ *provide sufficient resources and personnel for implementation,*
- ◆ *initiate action to assure compliance,*
- ◆ *identify and record any environmental problems,*
- ◆ *initiate, recommend or provide solutions to those problems through designated channels,*
- ◆ *verify the implementation of such solutions,*
- ◆ *control further activities until any environmental deficiency or unsatisfactory condition has been corrected, and*
- ◆ *act in emergency situations.*


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MANAGEMENT'S RESPONSIBILITY

The consolidated financial statements of Primex Forest Products Ltd. have been prepared by management in accordance with generally accepted accounting principles in Canada. The financial information contained elsewhere in the annual report is consistent with the consolidated financial statements.

Management maintains a system of internal controls over financial reporting, which encompasses policies, procedures and controls to provide reasonable assurance that assets are safeguarded against loss or unauthorized use, that transactions are executed and recorded in accordance with management's authorization and that financial records are accurate and reliable.

The Audit Committee, which is comprised of a majority of outside directors, meets periodically with management and the external auditors to review the adequacy of the system of internal controls and the integrity of the Company's financial reporting.

The consolidated financial statements have been reviewed by the Audit Committee prior to submission to the Board. In addition, the consolidated financial statements have been audited by Price Waterhouse, Chartered Accountants, who have full access to the Audit Committee with and without the presence of management. Their report follows.



G.L. Malpass
President & Chief Executive Officer



P.D. Rivers
Vice President - Finance
Chief Financial Officer

February 18, 1998

AUDITORS' REPORT

February 18, 1998

To the Shareholders of Primex Forest Products Ltd.

We have audited the consolidated balance sheets of Primex Forest Products Ltd. as at December 31, 1997 and 1996 and the consolidated statements of earnings and earnings reinvested in the business and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit

also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.



Chartered Accountants
Vancouver, B.C., Canada

CONSOLIDATED

STATEMENT OF EARNINGS

AND EARNINGS REINVESTED IN THE BUSINESS


Year ended December 31

1997
1996

(in thousands of dollars)

Sales and other income (Note 7)	\$ 155,784	\$ 170,672
Expenses		
Cost of sales	130,824	141,795
Ocean freight	13,684	14,718
Selling and administration	4,743	4,932
Depreciation and amortization	4,104	3,902
Interest on long-term debt	258	53
Interest (income) expense	(292)	312
Loss (gain) on disposal of fixed assets	22	(1)
	153,343	165,711
Earnings before income taxes	2,441	4,961
Provision for income taxes (Note 8)		
Current	1,987	2,522
Deferred	(1,085)	(1,032)
	902	1,490
Net earnings for year	1,539	3,471
Earnings reinvested in the business, beginning of year	56,595	54,515
Dividends paid (\$0.16 per share (1996 - \$0.16))	(1,391)	(1,391)
Earnings reinvested in the business, end of year	\$ 56,743	\$ 56,595
Basic earnings per share (Note 6)	\$ 0.18	\$ 0.40


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CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION



Year ended December 31
1997 1996

(in thousands of dollars)

Cash provided by (used for)

Operations

Net earnings for year	\$ 1,539	\$ 3,471
Items not affecting cash		
Depreciation and amortization	4,104	3,902
Loss (gain) on disposal of fixed assets	22	(1)
Deferred income taxes	(1,085)	(1,032)
	4,580	6,340
Changes in non-cash working capital		
Accounts receivable	11,854	(9,247)
Inventories	1,792	(2,160)
Other	962	(552)
Accounts payable and accruals	(3,402)	3,302
Income taxes	(804)	67
	10,402	(8,590)
	14,982	(2,250)

Financing activities

Proceeds of long-term debt	5,512	354
Repayment of long-term debt	(1,037)	(6,889)
Dividends paid	(1,391)	(1,391)
	3,084	(7,926)

Investing activities

Purchase of property, plant and equipment	(2,117)	(3,814)
Proceeds on disposition of fixed assets	169	128
Acquisition of interest in B.W. Creative Wood Industries Ltd.	(2,693)	-
	(4,641)	(3,686)

Increase (decrease) in cash 13,425 (13,862)

(Bank indebtedness) cash, beginning of year (5,612) 8,250

Cash (bank indebtedness), end of year \$ 7,813 \$ (5,612)

CONSOLIDATED BALANCE SHEET



	December 31	
	1997	1996
	(in thousands of dollars)	
ASSETS		
Current assets		
Cash	\$ 7,813	\$ -
Accounts receivable	14,357	24,629
Inventories (Note 4)	29,023	29,570
Income taxes receivable	324	-
Other	1,633	1,832
	53,150	56,031
Property, plant and equipment		
Equipment	52,492	50,059
Buildings	8,534	7,479
Leasehold improvements	1,944	1,805
	62,970	59,343
Less: Accumulated depreciation	28,994	24,338
	33,976	35,005
Land	817	133
	34,793	35,138
	\$ 87,943	\$ 91,169



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CONSOLIDATED BALANCE SHEET



	December 31	
	1997	1996
	(in thousands of dollars)	
LIABILITIES		
Current liabilities		
Bank indebtedness	\$ -	\$ 5,612
Accounts payable and accruals	10,539	13,004
Income taxes payable	-	421
Long-term debt due within one year (Note 5)	931	606
	11,470	19,643
Long-term debt (Note 5)	6,071	1,032
Deferred income taxes	9,965	10,205
	27,506	30,880
SHAREHOLDERS' EQUITY		
Share capital (Note 6)		
<i>Authorized</i>		
100,000,000 common shares of no par value		
<i>Issued</i>		
8,690,664 shares	3,694	3,694
Earnings reinvested in the business	56,743	56,595
	60,437	60,289
	\$ 87,943	\$ 91,169

Commitments (Note 10)

Approved by the Board

Director

Director



1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

All material intercompany transactions have been eliminated.

Investments

The investments in Field Sawmills Limited Partnership and B.W. Creative Wood Industries Ltd. (Note 2) are accounted for by the proportionate consolidation method (Note 3).

Inventories

Cost is determined on the first-in, first-out (FIFO) basis. The inventories are valued as follows:

Logs	- lower of cost and replacement cost
Lumber	- lower of cost and estimated net realizable value
Chips and sawdust	- net realizable value
Operating supplies	- cost

Logging development costs

Logging development costs are being amortized on a unit-of-production basis, based on estimated total logging costs and log production, by area, within the Company's timber licenses.

Property, plant and equipment

Property, plant and equipment are stated at cost. The costs of repairs and replacements of a routine nature are charged to earnings while those expenditures which improve or extend the useful lives of the assets are capitalized.

Depreciation is provided using the straight-line method at rates sufficient to amortize the costs over the estimated useful lives of the assets as follows:

Buildings and yard	20 to 40 years
Plant equipment	15 years
Mobile equipment	3 to 5 years
Other	2 to 5 years
Leasehold improvements	over the lease term

Foreign currency translation

The Company uses forward exchange contracts to hedge a portion of its foreign currency denominated

sales and related accounts receivable. Amounts receivable so hedged are translated at the forward exchange contract rates. Other amounts receivable and payable in foreign currencies are translated to Canadian dollars at the year-end rate of exchange. Revenue and expenses not hedged are translated throughout the year at the prevailing exchange rates. All exchange gains and losses are included in the determination of net earnings for the year.

Derivative financial instruments

Derivative financial instruments in the form of foreign exchange contracts are utilized to hedge certain transactions denominated in foreign currencies, primarily export sales. These instruments serve to protect the Company from currency fluctuations between the transaction date and settlement. The Company does not hold or issue financial instruments for trading purposes.

Use of estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

2. ACQUISITION

Effective April 1, 1997, the Company acquired an indirect 49% interest in B.W. Creative Wood Industries Ltd. (BW). BW owns and operates a speciality wood products plant in Maple Ridge, B.C. The results of operations are proportionately consolidated in the accompanying financial statements. The purchase price was allocated based on fair values as follows:

	(in thousands of dollars)
Net assets acquired	
Current assets, net	\$ 2,056
Property, plant and equipment	1,652
	3,708
Less	
Long-term debt assumed	910
Deferred income taxes	105
	1,015
Cash consideration	\$ 2,693

3. INVESTMENT IN JOINT VENTURES

The Company maintains a 70% partnership interest in Field Sawmills Limited Partnership. The 30% partnership interest is held by MacMillan Bloedel Limited. The Company also has an indirect 49% interest in B.W. Creative Wood Industries Ltd.

The Company's proportionate share of the assets, liabilities, revenues, expenses and cash flows of the Joint Ventures are summarized as follows:

	1997	1996
	(in thousands of dollars)	
Assets		
Current assets	\$ 17,604	\$ 15,617
Property, plant and equipment, net	15,092	13,788
Total assets	32,696	29,405
Liabilities		
Current liabilities	8,958	10,405
Long-term debt, net of current portion	6,071	1,032
Deferred income taxes	105	—
Total liabilities	15,134	11,437
Proportionate share of net assets	\$ 17,562	\$ 17,968
Sales and other income	\$ 48,222	\$ 54,600
Expenses	51,207	55,792
Share of loss for year	\$ (2,985)	\$ (1,192)
Cash provided by (used for)		
<i>Operations</i>	\$ 572	\$ 764
<i>Financing activities</i>	\$ 4,170	\$ (2,799)
<i>Investing activities</i>	\$ (1,066)	\$ (1,916)

4. INVENTORIES

	1997	1996
	(in thousands of dollars)	
Logs	\$ 18,737	\$ 22,862
Lumber	9,031	6,517
Chips	1,086	80
Operating supplies	169	111
	\$ 29,023	\$ 29,570

5. LONG-TERM DEBT

	1997	1996
	(in thousands of dollars)	
Proportionate share of floating rate term bank loan at prime plus 3/8%, secured by a general security agreement, an assignment of inventory and a collateral mortgage for \$12,200,000 (1996 - \$12,200,000) which provides a first charge on land and buildings of the joint venture. This bank loan contains covenants requiring bank consent on certain activities and the maintenance of specified financial conditions, maturing in 2002	\$ 5,684	\$ 1,288
Proportionate share of match funded term loan with interest at 7.44% secured by a registered collateral mortgage maturing in 2005	715	—
Proportionate share of capital lease obligations on certain equipment with interest averaging 5.8% repayable in monthly instalments, maturing in 2000	431	324
Proportionate share of demand term loan with interest at prime plus 3/4%, renewable yearly, secured by a general security agreement over all assets of the joint venture, assignment of inventory and a third party guarantee for \$221,000	118	—
Term loan on equipment with no interest, maturing in 1998	54	26
	7,002	1,638
Less: Amounts due and repayable in one year	931	606
	<u>\$ 6,071</u>	<u>\$ 1,032</u>

The Company has unused banking facilities available. These facilities are secured by a demand debenture of \$30,000,000 (1996 - \$30,000,000) which provides a fixed charge on certain property, plant and equipment, a floating charge on all other assets and contains covenants requiring bank consent on certain activities and maintenance of specified financial conditions.

Joint venture indebtedness is non-recourse to the Company.

Annual payments of principal required to meet debt obligations are as follows:

	(in thousands of dollars)
1998	\$ 931
1999	753
2000	652
2001	533
2002	3,695
Thereafter	438
	<u>\$ 7,002</u>

6. SHARE CAPITAL

The following stock options, granted to directors and key employees under the Company's executive stock option plan, are outstanding as at December 31, 1997:

Year of grant	Number of shares	Price	Exercise period	Expiry Date
1992	580,000	\$ 4.50	1997 - 2002	March 11, 2002
1995	2,000	\$ 8.75	2000 - 2005	July 18, 2005
1996	2,000	\$ 7.75	2001 - 2006	March 1, 2006
1997	22,000	\$ 7.45	2002 - 2007	July 24, 2007

Fully diluted earnings per share, which have been calculated on the basis that all stock options were exercised on the date of grant notwithstanding their earliest exercise date, were \$0.17 per share for the year ended December 31, 1997, based on 9,296,664 net shares outstanding during the year (\$0.38 per share for 1996 based on 9,296,664 net shares for that year). Basic earnings per share calculations have been based on 8,690,664 (1996 - 8,690,664) weighted average net outstanding shares during the year.

7. SEGMENTED INFORMATION

Sales and other income by major markets are as follows:

	1997	1996
	(in thousands of dollars)	
Japan	\$ 111,150	\$ 122,448
Canada	15,160	24,106
United States	18,806	17,202
Europe and other	10,668	6,916
	<u>\$ 155,784</u>	<u>\$ 170,672</u>

8. INCOME TAXES

The effective tax rate of the Company for the years ended December 31, 1997 and 1996 differed from the combined federal and provincial statutory rates as follows:

	1997	1996
Combined federal and provincial statutory rate	45.6%	45.6%
Manufacturing and processing allowance	(7.0%)	(7.0%)
Subtotal	38.6%	38.6%
Other	(1.6%)	(8.6%)
Effective tax rate	<u>37.0%</u>	<u>30.0%</u>

9. FINANCIAL INSTRUMENTS

Credit risk

Although the majority of the Company's lumber sales are to the Japanese market, the credit risk arising from concentration in this market is minimized as lumber sales are realized from a number of large customers and are generally secured by letters of credit or equivalent instruments of guarantee. The Company deals only with highly rated financial institutions for these instruments. Log sales, mainly to the domestic market, are generally transacted on a cash basis. As a result, the Company is not exposed to significant risk of credit-related losses.

Foreign exchange risk

The majority of the Company's lumber sales are denominated in U.S. dollars. The Company is exposed to risk of loss depending on the relative movement of this currency against the Canadian dollar. Exposure to foreign exchange fluctuations is managed through the use of forward exchange contracts.

At December 31, 1997, foreign exchange contracts had a contracted amount of U.S. \$10,898,000. Those outstanding at December 31, 1997 all have maturities of less than one year. The fair value of these instruments approximates carrying value.

Long-term debt

The fair value of long-term debt approximates book value at December 31, 1997 and 1996.

Current assets and liabilities

The carrying values reported in the balance sheet for cash, accounts receivable, bank indebtedness, accounts payable and accruals are reasonable estimates of fair values.

10. COMMITMENTS

The Company is obligated under operating lease agreements for aggregate basic annual rentals of approximately:

	(in thousands of dollars)
1998	\$ 385
1999	\$ 231
2000	\$ 196
2001	\$ 151
2002	\$ 142

11. PENSION PLANS

The majority of the Company's salaried employees are eligible to participate in pension plans after one year of service. Required company contributions are based on a percentage of compensation and are charged to earnings as incurred. The majority of the Company's hourly paid workers are enrolled in a pension plan into which the Company pays a rate per hour worked. These payments are charged to earnings as incurred.

CORPORATE INFORMATION



DIRECTORS

LORNE R. BOLTON*

Director/Secretary
Kensington International Inc.

GEORGE L. MALPASS

President & Chief Executive Officer
Primex Forest Products Ltd.

CONRAD A. PINETTE*

President and Chief Operating Officer
Lignum Ltd.

DONALD H. REED* Consultant

PAUL D. RIVERS*

Vice President - Finance & Secretary
Primex Forest Products Ltd.

JOHN P. SULLIVAN

Vice President - Corporate Development
Primex Forest Products Ltd.

* Members of the Audit Committee

OFFICERS

GEORGE L. MALPASS

President & Chief Executive Officer

WILLIAM C. COMMON

Vice President - Operations

PAUL D. RIVERS

Vice President - Finance & Secretary

JOHN P. SULLIVAN

Vice President - Corporate Development

Some specialty products from
B.W. Creative Wood Industries Ltd.

REGISTRAR AND TRANSFER AGENT

The Montreal Trust Company
Vancouver, B.C., Toronto, Ontario

SHARES LISTED

The Toronto Stock Exchange - PXF
The Vancouver Stock Exchange - PXF

BANKERS

Royal Bank of Canada

SOLICITORS

McCarthy Tétrault, Vancouver, B.C.

AUDITORS

Price Waterhouse, Vancouver, B.C.

HEAD OFFICE

9924 River Road, Delta, B.C. V4G 1B5
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REGISTERED OFFICE

Suite #1300 - 777 Dunsmuir Street,
Vancouver, B.C. V7Y 1K2

ANNUAL MEETING

Wednesday April 29, 1998, 2:30 p.m.
The Four Seasons Hotel, Vancouver, B.C.

OPERATIONS AND INVESTMENTS

- Acorn Forest Products Division, Delta, B.C.
- Specialty Products Division, Delta, B.C.
- Field Sawmills Limited Partnership, Courtenay, B.C.
A partnership with MacMillan Bloedel Limited
- Timber Division, Courtenay, B.C.
- Primex Fibre Ltd., Delta, B.C.
- Primex Log Trading Ltd., Delta, B.C.
- B.W. Creative Wood Industries Ltd., Maple Ridge, B.C.



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